Structured Settlements or

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and

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Chances are, when settling personal injury cases these days, an adjuster will recommend a "structured settlement." This is a proposal that requires careful consideration. In the wake of September 11, the stability and solvency of our insurance system is under scrutiny as never before.

Structured settlements involve purchasing an annuity contract, a form of life insurance, that will pay a benefit over a long term, generally the lifespan of the client. That means, whatever instrument selected as part of the settlement package must be as secure as possible. If a problem arises, chances are the client will look to counsel for satisfaction of any losses.

This article examines what is a structured settlement and what kinds of problems structures can create for plaintiff's counsel.

Understanding Annuities — The "Structured Settlement"

Annuities are a special form of insurance that are closely related to life insurance. They are regulated by the Insurance Code, beginning with Insurance Code section 101. An annuity contract is not a life policy per se, since the risk assumed in a life policy is to pay upon an insured's death. The risk assumed in an annuity contract is to pay as long as the insured might live. *In re Barr's Estate*, 104 Cal. App. 2d 506, 231 P.2d 876 (1951).

Though most personal injury claims are settled for a one-time, lump-sum payment, for years structured settlements have been used in personal injury cases to compensate all types of injury victims. In a lump-sum settlement, the client bears the obligation to secure a fair yield on their investment or to spend the funds in a responsible fashion. In a structured settlement, that job is taken over by the annuity company, which provides a sort of "guarantee" of a positive result.

Understanding annuities may become especially important after judgment in a medical malpractice action. Code of Civil Procedure section 667.7 mandates that, if requested, the trial court shall order that any judgment in excess of fifty thousand dollars be paid in whole or in part by periodic payments rather than by a lump sum. *See Holt vs. Regents of University of California*, 73 Cal. App.4th 871, 86 Cal. Rptr. 2d 752 (1999), for a discussion on figures and methodology for determining the periodic payments and calculation of attorneys fees in a medical malpractice action.

In a structured settlement, a voluntary agreement is reached between the parties under which the client receives damages in the form of agreed-upon future periodic payments, which can also include a present, partial lump-sum payment. The defendant's insurance carrier sends the settlement funds directly to the structure company of choice. The future periodic payments come from a well-capitalized, financially experienced institution and are tailored to help ensure the financial security of the claimants and their family. These payments are typically funded through an annuity.

An annuity contract is issued by a life insurance company and is funded with a single premium (i.e., the client's net settlement). The investment portfolio of the life insurance company provides competitive rates of return from which the claimant and/or their attorney (more on that below) receive periodic payments over time.

Which Clients Might Benefit from Structured Settlements?

Almost all cases involving minors warrant considering a structured settlement, especially since young adults often have difficulty managing money if they are suddenly given large sums upon reaching majority. Probate Code section 3611(b) sets forth the methods of distribution of funds to a minor and includes a *single-premium annuity* as an approved financial mechanism in the best interests of the child.

There are several benefits of a structured settlement to a minor in a personal injury action. First, the interest earned in blocked accounts is taxable, even if the original principal was not. No so with an annuity. Not only is the money invested non-taxable (assuming there is a physical injury), the entire payout is also tax free so long as all requirements have been met. Moreover, the rate of return for an annuity is typically higher than a blocked account. (Specific IRS provisions are beyond the scope of this article. Please consult a qualified tax consultant for further information.)

Furthermore, in a blocked account, once the minor turns 18 years, all of the money is available. With an annuity, the guardian ad litem can specify a provision for educational needs by making specified annual payments during college years. Also, the guardian ad litem may specify a final payment at age 30 when the minor is presumably more fiscally responsible than at age 18.

Structured settlements are also ideally suited for cases involving: (1) wrongful death cases where replacing income to the surviving spouse or children is a concern; (2) where establishing a memorial fund in the name of a loved one is a goal; (3) in guardianship cases involving those incapable of

providing for themselves financially; (4) in providing for monthly mortgage payments, or; (5) where securing retirement income or enhancing an existing retirement account is desired.

Structured Settlements and Attorney's Fees

Structured settlements also may provide the settling attorney with tax benefits separate and apart from those enjoyed by the client.

The tax court ruled favorably in a recent IRS challenge to an attorney who structured his fee. The tax court's decision regarding the taxability of structured fees in *Childs vs. Commissioner*, No. 15639.92 (Tax Ct., Nov. 14, 1994) held the fair market value of attorney's rights to receive payments under the structured settlement agreement were not included in income in the year in which the settlement agreements were effected.

Accordingly, it appears that structured income is tax-*deferred* to a plaintiff's attorney. Attorney's fees are taxable in the year received. The attorney may structure his fee differently than that of the client. For example, if the client wanted pay-outs beginning in 20 years, the attorney could chose a 10 year pay-out, monthly pay-outs, etc. having no similarity to the decisions of the client.

The tax-deferred nature of structuring a fee can be particularly helpful in high income years. Instead of taking a big tax hit in the year of settlement, annuitizing a fee can spread out the tax-bite over a period of many years.

Attorneys considering whether or not to recommend an annuity, may want to check or revise their retainer agreements. In *Sayable v. Feinman*, 76 Cal. App. 3d 509, 142 Cal. Rptr. 895 (1978), the funds from a wrongful death settlement were placed into an annuity. The contingency fee-retainer agreement allowed the attorney a percentage of "any money recovered." The trial court interpreted that phrase to allow collection of the attorney's contingency fee only as the client received funds in monthly installments, not in a lump-sum as requested by the attorney. The Court of Appeal agreed with the trial court, finding the attorney's interpretation of the contingency fee "oppressive."

Practice Tips

There are numerous consultants available who will ensure that the annuity purchased with the settlement fund is the best deal for the client. Consider enlisting this specialized assistance. Ultimately, it will help avoid headaches and point out any dangers in the defendant's proposed structure.

New issues arise when dealing with structured settlements. For example, in *Sisco v. Cosgrove Michelizzi Schwabacher Ward & Bianchi*, 51 Cal. App.4th 1302, 59 Cal. Rptr. 2d 647 (1996), the mother of a decedent in a sexual molestation action brought a claim for legal malpractice against the attorneys alleging that they were negligent in failing to ensure that she would be the sole beneficiary of decedent's structured settlement proceeds upon his death, thereby allowing the father to inherit half of the proceeds.

The trial court dismissed the action. Affirmed on appeal, the court found that the mother suffered no damages because the court in the underlying action could not have approved a settlement designating the mother as the sole beneficiary. Even so, *Sisco* provides an object lesson, that is, an attorney must beware of potential malpractice liability where a structure is not carefully crafted.

The client's fiduciary counsel must adequately inform the client of all material facts regarding the risks and benefits of annuities. *See Stoll vs. Superior Court*, 9 Cal. App. 4th 1362, 12 Cal. Rptr. 2d 354 (1992). Once the annuity is funded, there is no turning back – the money cannot be taken out early.

There is always a slight chance that the company may be defunct when it comes time to make the payments. At the hearing on the minor's compromise, an additional question to ask the petitioner is whether she is aware of that risk and is willing to undertake it. If no minor is involved, make sure the risk is described to the client in writing.

Also, annuity rates vary from one company to another. Rates are influenced by age of the plaintiff, life expectancy and type of injury.

In addition, look for an annuity which is "guaranteed." The guarantee aspect means that the annuity will continue to pay a designated beneficiary of the claimant should the claimant pass away prior to completion of the payments.

Conclusion

Claims professionals, claimant attorneys, judges and defense attorneys advocate the use of structured settlements because they can effectively meet a claimant's needs for security as well as provide more benefits over time than a single, lump-sum settlement. While structured settlements may not work in every case, they should always be kept in mind for use in the right case. ■

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